

STATE OF MICHIGAN
OFFICE OF FINANCIAL AND INSURANCE SERVICES

IN THE MATTER OF)
MERRILL LYNCH, PIERCE, FENNER &) SETTLEMENT AGREEMENT
SMITH, INC.)
_____)

THE OFFICE OF FINANCIAL AND
INSURANCE SERVICES

TO: Merrill Lynch, Pierce, Fenner & Smith, Inc.

WHEREAS, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") is a broker-dealer registered in the State of Michigan; and

WHEREAS, the Office of Financial and Insurance Services of the State of Michigan, (the "Agency") has undertaken an investigation (the "Investigation") into the activities of Merrill Lynch relating to certain research practices at Merrill Lynch; and

WHEREAS, the Attorney General of the State of New York ("New York AG") conducted an investigation (the "New York Investigation") into research practices at Merrill Lynch; and

WHEREAS, the New York AG commenced a proceeding on April 8, 2002, pursuant to Section 354 of the General Business Law of the State of New York (Index No. 02/401522) (the "New York Proceeding"), including submission of the Affidavit of Eric R. Dinallo, Chief of Investment Protection Bureau, New York State Department of Law, containing assertions regarding the research practices of Merrill Lynch (the "Dinallo Affidavit"), which is on file in the New York Proceeding; and

WHEREAS, the New York AG and Merrill Lynch have entered into an agreement, dated May 21, 2002 (the "May 21 Agreement"), a copy of which has been provided to the Office of Financial and Insurance Services, which resolved all issues involved in the New York Investigation and the New York Proceeding, prior to the Court making any findings of fact or conclusions of law pursuant to a contested proceeding; and

WHEREAS, pursuant to the May 21 Agreement, Merrill Lynch has agreed to implement certain changes with respect to its Global Equity Research analysts and equity securities covered by such analysts and make certain payments; and

1
2
3 WHEREAS, Merrill Lynch and the Office of Financial and Insurance Services are desirous of
4 avoiding multiple investigations in light of the above-referenced changes that are being implemented at
5 Merrill Lynch and Merrill Lynch's agreement to make certain payments; and

6 WHEREAS, Merrill Lynch admits the jurisdiction of Office of Financial and Insurance Services;
7 **IT IS HEREBY AGREED:**

8 1. This Agreement concludes the Investigation by the Office of Financial and Insurance Services and
9 any other action that the Office of Financial and Insurance Services could commence under applicable state
10 law on behalf of Michigan as it relates to Merrill Lynch, its affiliates, current or former employees, officers
11 and directors of Merrill Lynch relating to research practices at Merrill Lynch.

12 2. This Agreement is entered into solely for the purpose of resolving the Office of Financial and
13 Insurance Services' Investigation, and is not intended to be used for any other purpose.

14 3. **Merrill Lynch further agrees that:**

15 (a) Merrill Lynch will comply with the Uniform Securities Act.

16 (b) As of the date hereof, Merrill Lynch will state on each Merrill Lynch Global Equity research
17 report whether Merrill Lynch received or is entitled to receive compensation over the past 12
18 months, or whether Merrill Lynch is entitled to receive compensation from any publicly
19 announced equity underwriting or merger and acquisition transaction for each company covered
20 by the research report (the "Covered Company"). Notwithstanding the foregoing, as of July 8,
21 2002, the disclosures regarding investment banking compensation referred to in Paragraph 3(b)
22 shall be replaced with the disclosures required by NYSE Rule 472(k)(1)(ii) and NASD Rule
23 2711 (h)(2)(A)(ii).

24 (c) As of the date hereof, Merrill Lynch will include a prominent legend on the first page of each
25 Merrill Lynch Global Equity research report that investors should assume that Merrill Lynch is
26 seeking or will seek investment banking or other business from the Covered Company.

27 (d) As of the date hereof, Merrill Lynch will include on each Merrill Lynch Global Equity research
report specific disclosure on a percentage basis, the aggregate distribution, calculated quarterly,
of the intermediate-term rating category used by Merrill Lynch, for

- 1 (i) all stocks in the sector or industry group applicable to the Covered
2 Company;
- 3 (ii) all stocks in the sector or industry group applicable to the Covered Company
4 for which, over the prior 12 months, Merrill Lynch performed services in
5 publicly announced equity underwritings and merger and acquisition
6 transactions for which compensation was received or to which Merrill
7 Lynch is entitled, until the effective date of any applicable rules promulgated
8 by any self-regulatory organization to which Merrill Lynch is subject;
- 9 (iii) all stocks covered by Merrill Lynch Global Equity research; and
- 10 (iv) all stocks covered by Merrill Lynch Global Equity research for which, over
11 the prior 12 months, Merrill Lynch performed services in publicly
12 announced equity underwriting or merger and acquisition transactions for
13 which compensation was received or to which Merrill Lynch is entitled,
14 until the effective date of any applicable rules promulgated by any self-
15 regulatory organization to which Merrill Lynch is subject.

16
17 **Research Changes**

18 4. Merrill Lynch agrees to adopt and enforce policies implementing the practices and procedures set
19 forth in Paragraphs 5-15 with respect to its U.S.-based equity research analysts and equity securities
20 covered by such analysts by no later than July 1, 2002, unless otherwise set forth below.

21 **Analyst Compensation**

22 5. Merrill Lynch will separate completely the evaluation and determination of compensation for U.S.-
23 based equity research analysts from Merrill Lynch's investment banking business by complying with
24 Paragraphs 6-9 below. Going forward, Merrill Lynch will consider the implementation of such additional
25 procedures as it deems appropriate to further effectuate the provisions of Paragraphs 6-9. All research
26 analyst employment contracts entered into starting as of the date hereof will make specific reference to the
27 Merrill Lynch policies implemented to effectuate the prohibitions set forth in Paragraph 7 of this
Agreement.

1 6. Merrill Lynch agrees that research analysts will be compensated for only those activities and
2 services intended to benefit Merrill Lynch investor clients. The activities and services that research
3 analysts are expected to perform for the benefit of Merrill Lynch investor clients include:

- 4 (a) formulation of research recommendations and preparation of research reports;
- 5 (b) communication of investment information to investor clients;
- 6 (c) cooperation, accessibility and responsiveness consistent with serving investor clients; and
- 7 (d) participation in the identification and evaluation of potential investment opportunities,
8 including providing input into whether a potential investment opportunity is appropriate for
9 Merrill Lynch investor clients.

10 7. With respect to analyst compensation, Merrill Lynch will prohibit:

- 11 (a) anyone responsible for determining research analysts' compensation from soliciting from
12 any analyst, or considering in determining any analyst's compensation, either (i) the amount
13 of investment banking revenue received from clients covered by such analyst, or (ii) the
14 analyst's participation in investment banking transactions, except to the extent such
15 activities and services are intended to benefit investors, as specifically contemplated by
16 Paragraph 6 above;
- 17 (b) research analysts from being evaluated by investment bankers for any work such analysts
18 may do to generate investment banking business, including participation in investment
19 banking client solicitations;
- 20 (c) investment bankers from communicating with research analysts or with anyone responsible
21 for determining analysts' compensation for the purpose of calculating or influencing an
22 individual analyst's compensations; and
- 23 (d) consideration of any such input from investment bankers by anyone responsible for
24 determining research analysts' compensation.

25
26 8. Merrill Lynch agrees that managers in Merrill Lynch's Research Department ("Research
27 Management") and those executive officers more senior to Research Management, subject to review at its

1 discretion by the Board of Directors, will have exclusive responsibility for determining research analyst
2 compensation and will evaluate analysts for compensation purposes based primarily upon:

- 3 (a) quality of analysts' research and performance of their investment recommendations;
- 4 (b) competitive compensation factors;
- 5 (c) surveys and input from investor clients; and
- 6 (d) surveys and input from Merrill Lynch's institutional sales, equity trading, and private client
7 divisions, but not from the investment banking division.

8
9 9. Executive management may discuss with Research Management overall costs, budgets, resource
10 allocation and the retention and recruitment of research analysts.

11 **Research Recommendations Committee**

12 10. On or before September 1, 2002, Merrill Lynch will establish a Research Recommendations
13 Committee (the "RRC"). The RRC will monitor performance of and supervise equity research
14 recommendations for objectivity, integrity, and a rigorous analytical framework in the development of all
15 recommendations.

- 16 (a) The RRC will be composed of representatives of Merrill Lynch's institutional and private
17 client sales management, Research Management and research strategists. It will be chaired
18 by an individual who will be compensated in a fixed amount plus a bonus based primarily
19 on how research recommendations (i.e., currently defined as strong buy, buy, neutral,
20 reduce/sell), perform for investors. Performance will be measured over relevant periods of
21 time by, among other things, absolute price performance against the recommendation
22 definitions included in the research reports and price performance relative to industry and
23 market benchmarks.
- 24 (b) Initiation of, or change to, any equity research recommendation will require approval by the
25 RRC. Changes to research recommendations may be approved by a member of the RRC
26 and ratified by the RRC.
- 27 (c) Upon presenting a research recommendation at a meeting of the RRC, the relevant
research analyst shall disclose to the RRC any participation by the analyst with

1 investment bankers in an investment banking transaction for the subject company within
2 the last 12 months.

3 (d) A member of the RRC or a member of Research Management, or a compliance manager
4 in the Research Department shall be present at any meeting of Merrill Lynch's Equity
5 Commitment Committee or any other group authorized to commit Merrill Lynch to a
6 public equity underwriting.

7 (e) The RRC Chairperson will report to the Director of Global Research.

8
9 11. As soon as practicable, but no later than December 31, 2002, Merrill Lynch will implement a
10 system to monitor electronic communications between investment bankers and equity research analysts.

11 Solicitation of Investment Banking Business

12 12. Merrill Lynch agrees that:

13 (a) Research analyst participation with investment bankers in solicitations for any potential
14 investment banking transaction must be approved in advance by Research Management.

15 (b) Effective September 1, 2002, before any research analyst participates in a solicitation
16 with investment bankers for any potential investment banking transaction, such analyst
17 must disclose such intended participation to a member of the RRC.

18 (c) Effective September 15, 2002, each equity research report covering a particular company
19 will disclose whether, since July 1, 2002, any research analyst covering such company
20 has participated in a solicitation with or at the request of investment bankers for an
21 investment banking transaction underwritten by Merrill Lynch. Commencing on July 1,
22 2003, such disclosure will be made for the immediately preceding 12 month period.

23 (d) Upon execution of this Agreement, Merrill Lynch will prohibit analysts, investment
24 bankers, or any other employees of Merrill Lynch from promising, implying, offering, or
25 communicating in any way that a specific recommendation or change of an existing
26 recommendation will be made in exchange for the awarding of an investment banking
27 transaction to Merrill Lynch.

- 1 (e) Upon execution of this Agreement, Merrill Lynch will prohibit analysts from changing
2 any research recommendation because of the subject company's decision not to retain
3 Merrill Lynch for investment banking services.

4 **Disclosure During Solicitation of Public Equity Underwriting**

5 13. On or before September 1, 2002, Merrill Lynch will establish a policy requiring that the materials
6 used in connection with any solicitation for a public equity underwriting will include a written disclosure
7 that:

- 8 (a) Merrill Lynch prohibits employees from, directly or indirectly, offering a favorable
9 research rating or specific price target, or offering to change a rating or price target to a
10 subject company as consideration or inducement for the receipt of business or for
11 compensation; and
12 (b) Merrill Lynch prohibits research analysts from being compensated for involvement in
13 investment banking transactions except to the extent that such participation is intended to
14 benefit investor clients.

15 **Termination of Coverage**

16 14. Whenever Merrill Lynch terminates coverage of any issuer, Merrill Lynch will publish a report
17 disclosing:

- 18 (a) Merrill Lynch's termination of coverage;
19 (b) the rationale for the decision to terminate coverage; and
20 (c) that, effective upon the termination of coverage, the last recommendation issued for the
21 particular stock should not be relied upon going forward.

22 **Compliance Monitor**

23 15. Merrill Lynch agrees that:

- 24 (a) Starting on or before September 1, 2002 and continuing for a period of one year, Merrill
25 Lynch will designate an employee (the "Compliance Monitor") whose assignment will be
26 to ensure compliance with the policies required by this Agreement.
27 (b) The Compliance Monitor will be appointed by Merrill Lynch subject to the acquiescence
of the New York AG, which acquiescence will not be unreasonably withheld.

1 (c) The Compliance Monitor will be available to research analysts to address issues of actual
2 or perceived undue influence or pressure from investment banking or any other source.

3 (d) The Compliance Monitor will report directly to the General Counsel for Litigation,
4 Compliance, Regulatory and Governmental Affairs.

5 16. Nothing herein shall be construed to require that Merrill Lynch or any of its affiliates, agents, or
6 employees, act in any manner inconsistent with any laws, rules, or regulations, including those imposed
7 by their governing self-regulatory organizations.

8 **No Disqualifications**

9 17. Neither this settlement, nor any acts performed and documents executed in furtherance of this
10 Agreement: (a) may be deemed or used as an admission of, or evidence of, the validity of any
11 wrongdoing or liability including, but not limited to the assertions in the Dinallo Affidavit, or anything
12 contained in the New York State Supreme Court Order, dated April 8, 2002; or (b) may be deemed or
13 used as an admission of, or evidence of, any such alleged fault or omission by Merrill Lynch & Co.,
14 Henry Blodget, Justin Baldauf, Kirsten Campbell, Virginia Syer Genereux, Sofia Ghachem, Thomas
15 Mazzucco, Edward McCabe and Deepak Raj, or any of them, in any civil, criminal, or administrative
16 proceeding in any court, administrative agency, or other tribunal; nor shall this Agreement confer any
17 rights upon any persons or entities who were not a party to this Agreement.

18 18. This Agreement is not intended to indicate that Merrill Lynch or any of its affiliates or current or
19 former employees should be subject to any disqualifications contained in the federal securities law, the
20 rules and regulations thereunder, the rules and regulations of self regulatory organizations or various
21 states' securities laws including any disqualifications from relying upon the registration exemptions or
22 safe harbor provisions, and this Agreement is not intended to form the basis of any such disqualification.

23 19. For any person or entity not a party to this Agreement, this Agreement, including, but not limited
24 to Paragraph 17 above, does not limit or create any private rights or remedies against Merrill Lynch
25 including, without limitation, the use of the Dinallo Affidavit, any e-mails or other documents of Merrill
26 Lynch or of others for research practices, limit or create liability of Merrill Lynch, or limit or create
27 defenses of Merrill Lynch to any claims.

20. Nothing herein is intended to or shall be construed to have created, compromised, settled or

1 adjudicated any claims, causes of action, or rights of any person whomsoever, other than as between Office
2 of Financial and Insurance Services and Merrill Lynch in accordance with this Agreement.

3 21. Any violation of the May 21 Agreement shall be deemed violation of this Agreement. Should
4 Merrill Lynch fail to abide by the terms and conditions of this Agreement or the May 21 Agreement,
5 nothing contained herein shall be construed to prevent the Office of Financial and Insurance Services from
6 exercising the authority to impose any remedy under the Uniform Securities Act against Merrill Lynch.

7 22. This Agreement shall not disqualify Merrill Lynch or any of its affiliates or current or former
8 employees from any business that they otherwise are qualified or licensed to perform under applicable
9 state law and this Agreement is not intended to form the basis for any disqualification.

10 23. Merrill Lynch shall pay the sum of \$1,655,684.00 made payable to the State of Michigan.

11 24. This payment is contingent upon written agreement, by the appropriate securities Agency of all
12 50 states, the District of Columbia and Puerto Rico, that the respective payment (referenced in Paragraph
13 24 of the May 21 Agreement) is made to each such Agency in consideration of the conclusion of any
14 investigation by each such respective Agency, the District of Columbia and Puerto Rico and any action
15 that each such respective Agency, the District of Columbia, and Puerto Rico could commence with
16 respect to research practices at Merrill Lynch. Merrill Lynch agrees and acknowledges that as to the
17 Office of Financial and Insurance Services, State of Michigan, this Agreement fully satisfies and complies
18 with such contingency and with the contingency set forth in the third sentence of paragraph 24 of the May
19 21 Agreement, which is fully incorporated into this Agreement.

20 25. If payment required pursuant to paragraph 23 is not made by Merrill Lynch for failure of any
21 contingency set forth in paragraph 24, the Office of Financial and Insurance Services may vacate this
22 Agreement at its sole discretion, upon 10 days notice to Merrill Lynch.

23 24 25 **General Provisions**

26 26. This Agreement and any dispute related thereto shall be construed and enforced in accordance with,
27 and governed by, the laws of the State of Michigan.

27 27. The parties represent, warrant and agree that they have received independent legal advice from their
attorneys with respect to the advisability of executing this Agreement.

1
2
3
4 WHEREFORE, the following signatures are affixed hereto this 13th day of September 2002.

5
6 Merrill Lynch, Pierce, Fenner & Smith, Inc.

7 By: _____

Office of Financial and Insurance Services

8 By: Frank M. Fitzgerald
9 Commissioner